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FISCAL IMPACT STATEMENT

LS 7485 **NOTE PREPARED:** Jan 20, 2011
BILL NUMBER: HB 1440 **BILL AMENDED:**

SUBJECT: Coal; Aggregate and Coal Bed Methane Taxation.

FIRST AUTHOR: Rep. Borders **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: *Petroleum Severance Tax.* This bill increases the petroleum severance tax rates to the greater of (1) 2% of the value of the petroleum (currently 1%); or (2) $0.06 per 1,000 cubic feet for natural gas that is not coal bed methane and $0.25 per 1,000 cubic feet for coal bed methane (currently ($0.03) and $0.48 per barrel for oil (currently $0.24).

Coal and Aggregate Severance Tax. The bill imposes a coal and aggregate severance tax upon persons that (1) remove coal from the earth; (2) process coal after its removal; or (3) extract aggregate from natural deposits. It imposes the tax at a rate of 4.5% of the gross value of the coal or aggregate removed or processed within a monthly reporting period. The bill provides for a minimum tax of $0.50 per ton. The minimum tax does not apply to taxpayers who process only coal. The bill provides the method of determining gross value.

Penalties. It provides penalties for the failure to pay or report the severance tax due. Officers of a corporation that fails to pay the tax are personally liable, jointly and severally, for the amount of unpaid tax.

Department of State Revenue (DOR). The DOR administers the tax.

Distribution. Tax revenue collected from the petroleum tax on coal bed methane and the coal and aggregate severance tax shall be distributed as follows: (1) 50% to the state General Fund; (2) 40% to the county in which the coal bed methane, coal, or aggregate is removed or processed and the cities and towns of the county based on population; (3) 10% to a new fund to make grants for parks and recreation projects throughout Indiana. Counties, cities, and towns must use the money from the distribution only for local road and street purposes.

Board. The bill establishes a 7-member board comprised of two governor appointments who are voting members, four legislative appointments who are nonvoting members, and the director of the Department of Natural Resources (DNR), who is a voting member, to decide grant awards from the new Parks and Recreation Grant Fund.

Effective Date: January 1, 2012.

Summary of NET State Impact:

	Estimated Annual Revenues	2010 Revenues	Increase
Oil	$2.5 M	$1,319,343	$1.18 M
Natural Gas	$558,000	$273,157	$286,843
Coal Bed Methane	$125,000	Incorporated in natural gas above	$125,000
Coal	$63 M	0	$63 M
Aggregate	$14.7 M	0	$18.75 M
Total			**$83.3 M**

Expenditures would equal administrative costs to the DOR and the DNR, plus $8,000 for the newly created board.

Distribution. Money received with respect to petroleum that is not coal bed methane must be paid by the DOR into the Oil & Gas Fund, which is used to finance administrative expenses. Based on the estimates above, the Oil & Gas Fund would receive an additional $1.18 M per year. The remaining $82.12 M would be distributed as outlined below.

Tax revenue collected from the petroleum tax on coal bed methane and the coal and aggregate severance tax must be distributed as follows: (1) 50% to the state General Fund; (2) 40% to the county in which the coal bed methane, coal, or aggregate is removed or processed and the cities and towns of the county based on population; (3) 10% to a new fund to make grants for parks and recreation projects throughout Indiana. Counties, cities, and towns must use the money from the distribution only for local road and street purposes.

Given this distribution formula, the state General Fund would see an increase of about $41 M. Counties would receive $32.8 M, and the grants for parks and recreation projects would receive $8.2 M.

Explanation of State Expenditures: *Department of State Revenue*: The DOR must administer the tax – prescribe forms, process applications for certificates and returns, and collect the tax. If a taxpayer fails to comply, the DOR may suspend or revoke the taxpayer's certificate of registration. These provisions will increase administrative and record keeping expenses for the DOR. The specific impact is indeterminable at this time. The DOR could administer the tax given resources generated by the tax.

Bonds. Each taxpayer charged with the duty to file reports and pay the severance tax must post a cash or corporate surety bond in an amount prescribed by the DOR. The DOR may bring an action for a restraining order or a temporary or permanent injunction to restrain or enjoin the taxpayer's business until the bond is posted. The DOR should be able to provide oversight given its existing level of resources or resources generated by the tax.

Rules. The DOR must adopt rules to implement the provisions of the bill. The DOR currently budgets for administrative expenses associated with adopting rules.

Department of Natural Resources. Any expenses incurred by the state for the administration of the provisions of the bill would be paid from the Oil & Gas Fund.

Special Holding Account. A special holding account within the state General Fund is established for depositing certain taxes collected and to receive transfers of petroleum severance taxes attributable to coal bed methane. The DOR must deposit monthly the taxes collected. Each month, the Treasurer of State must transfer and distribute the money in the account at the end of the preceding month as follows:

(1) 50% to the General Account of the state General Fund.

(2) 40% to be allocated among the counties in which coal, aggregate, and/or coal bed methane is severed or processed.

(3) 10% to the Parks and Recreation Grant Fund.

The Treasurer of State must distribute to the county treasurer the amount of severance taxes imposed in the county. Money in the account is appropriated to make the distributions to counties and to the Parks and Recreation Fund. Money in the account at the end of a state fiscal year does not revert to the state General Fund. A distribution from the account must be made by warrants issued by the Auditor of State to the Treasurer of State ordering the appropriate payments.

Parks and Recreation Grant Board. The board consists of 7 members: the DNR director, a member appointed by the Governor who must have an interest in and knowledge of parks and recreation; the executive director of the Indiana Park and Recreation Association; and 4 nonvoting legislators. The director must serve on the board without additional compensation. Voting members of the board or an adviser are not entitled to per diem, but are entitled to reimbursement for traveling expenses and other expenses actually incurred in connection with duties. The board must meet at least quarterly. Expenses for the board are estimated at less than $8,000. Because the Chair of the Board is the DNR Director, administrative costs would be covered by the DNR. The DNR should be able to provide administrative support to the board given its existing level of resources.

Parks and Recreation Grant Fund. The fund must be administered by the board. Money in the fund is appropriated to make grants. Money in the fund at the end of a state fiscal year does not revert to the state General Fund. A grant may not exceed 50% of the applicant's project costs.

Effect on State As an Employer. Costs to the state for products taxed could also increase if cost increases to the provider are passed through to the state.

Explanation of State Revenues: *Petroleum Severance Taxes.* The bill increases the petroleum severance tax rates to the greater of 2% of the value of the petroleum (currently 1%) or

$0.06 (currently $0.03) per 1,000 cubic feet for natural gas that is not coal bed methane;

$0.25 (currently $0.03) per 1,000 cubic feet for coal bed methane; and

$0.48 (currently $0.24) per barrel for oil.

The table below outlines crude oil, natural gas, and coal bed methane production by year.

Oil, Natural Gas, and Coal Bed Methane Production by Year			
Year	Oil (bbls)	Natural Gas (mcf)	Coal Bed Methane (mcf)*
2007	1,726,553	3,431,974	250,000
2008	1,858,311	4,301,382	400,000
2009	1,803,982	4,477,163	450,000
2010	1,840,448	6,112,082	500,000
*estimated CBM production			
**2010 includes estimated production for November and December.			

The tables below outline crude oil and natural gas pricing by year as reported to the DOR for Petroleum Severance Tax purposes.

Crude Oil ($/bbl) Prices			
Year	Minimum	Maximum	Average
2007	$48.10	$87.82	$65.44
2008	$35.19	$127.78	$93.21
2009	$33.04	$71.54	$55.54
2010	$69.23	$78.28	$71.99

Natural Gas ($/mcf) Prices			
Year	Minimum	Maximum	Average
2007	$4.64	$7.06	$5.87
2008	$5.68	$10.04	$7.54
2009	$3.25	$5.51	$4.07
2010	$3.55	$5.10	$4.31

Crude oil prices vary throughout the U.S. and the world. Domestic crude oil prices based on either the NYMEX price or the West Texas Intermediate (WTI) price are higher than the price that Indiana oil producers receive for their crude oil. Most of Indiana's crude oil is purchased by Countrymark for processing at their Mt. Vernon refinery. Other Indiana crude oil purchasers include Plains Marketing, Bi-Petro, and

Fishburn Services. These purchasers set their own price for crude oil purchased from Indiana producers. Their posted prices are regularly below nationally reported crude oil prices by approximately $4 to $7/bbl.

Estimated Oil Production and Revenue. Indiana's crude oil production is projected to remain relatively flat (as it has been for the past 3 or 4 years) at 1.8 million barrels annually for the next 3 or 4 years. However, the value of crude oil, as can be seen in the table above, has been somewhat volatile during the period 2007 to 2010. Predictions of the price of crude are less reliable. The average annual prices might vary from between $65 to $85 per barrel over the next several years.

A 2% severance tax for annual oil production at a rate of 1.8 million barrels, for an average price of $70/bbl, would result in annual revenue of $2.5 M (1.8 million * $70 * 0.02).

Natural Gas. Indiana's total annual gas production is projected to continue to increase by 10%. If 2010 production level increased by 10%, 2011 production levels would increase to 6.7 million mcf. Of this total, 500,000 mcf are estimated to be coal bed methane (CBM).

Prices for natural gas are projected to remain fairly flat for the next 4 or 5 years at a range between $4 to $5/mcf annually. A 2% severance tax for annual natural gas production at a rate of 6.2 million mcf, at an average price of $4.50/mcf, would result in annual revenue of $558,000 (6.2 million * $4.50 * 0.02). As long as natural gas sells at $3 or higher, the 2% rate will always apply.

Coal Bed Methane. Of the total estimated natural gas production for 2011, 500,000 mcf are estimated to be coal bed methane. Coal bed methane would be taxed at a rate of $0.25 per mcf, which would generate $125,000.

Total tax revenue at these rates would be approximately $3.18 M annually. Projected revenue based on the current 1% severance tax would be approximately $1.59 M annually, for an increase in revenue of $1.59 M.

These calculations are based on the assumptions noted above. Actual revenue will fluctuate as market prices for crude oil and natural gas vary and as production levels vary.

Coal Severance Tax. The bill imposes a minimum $0.50 tax and a maximum 4.5% severance tax on each taxpayer engaged in severing or processing coal in Indiana. There is approximately 35 million tons of coal severed from the ground each year. About 95% is processed at the mine and taken to a utility company. Coal sells for about $40 per ton. (The minimum tax would apply when the value per ton equaled $12.50) Applying the $40 per ton price with a production of 35 million tons, the total value of coal would equal $1.4 B to $1.62 B. Applying a 4.5% severance tax would result in revenue of $63 M.

The proposal contains provisions for special circumstances.

Aggregate Severance Tax. The bill imposes a 4.5% severance tax on each taxpayer engaged in severing aggregate in Indiana. Gross value equals the amount received or receivable by the taxpayer for the sale of the coal. In the absence of a sale, gross value is the fair market value for coal or aggregate of a similar grade and quality.

Estimated Revenue Generated by Aggregate				
Type of Aggregate	**2009 Tons**	**Average Price Per Ton**	**Dollar Value**	**Estimated Tax Revenue at 4.5%**
Crushed Stone	48,611,871	$5.97	$290 M	$13 M
Sand & Gravel	20,800,000	$4.81	$100 M	$4.5 M
Blast Furnace Slag	5,000,000	$5.62	$28.1 M	$1.25M
Total				**$18.75 M**

Penalties: A taxpayer who recklessly, knowingly, or intentionally severs aggregate or severs or processes coal in Indiana without obtaining a certificate of registration, or after a certificate of registration has been revoked, commits a Class B misdemeanor. A taxpayer that knowingly, recklessly, or intentionally (1) fails to file returns; (2) fails to remit the tax due; or (3) falsifies or alters a certificate or other form; commits a Class B misdemeanor. If additional court cases occur and fines are collected, revenue to both the Common School Fund (from fines) and the state General Fund (from court fees) would increase. The maximum fine for a Class B misdemeanor is $1,000. However, any additional revenue would likely be small.

If a taxpayer fails to pay the full amount of tax, fails to report the tax due, falsifies a return, or incurs a deficiency upon the determination of the DOR, the taxpayer is subject to a penalty and interest on the unpaid tax. Under existing law, the interest is the adjusted rate established by the commissioner. The adjusted rate of interest is the percentage rounded to the nearest whole number that equals two percentage points above the average investment yield on state money for the state's previous fiscal year, excluding pension fund investments, as determined by the Treasurer of State. Penalties vary according to the offense. The amount of revenue that will be generated by this proposal is indeterminable. Penalties and interest are deposited in the state General Fund.

<u>Explanation of Local Expenditures:</u> *Taxes for County Highways.* Currently, all expenses incurred in the maintenance of county highways must be paid out of funds from the gasoline tax, special fuel tax, and the motor vehicle registration fees that are paid to the counties by the state, and from funds derived from one or more of the following:

(1) County motor vehicle excise surtax.
(2) County wheel tax.
(3) County adjusted gross income tax.
(4) County option income tax.
(5) Riverboat admission tax (IC 4-33-12). or
(6) Riverboat wagering tax (IC 4-33-13).

The bill adds

(7) Petroleum severance taxes (IC 6-8-1) attributable to coal bed methane.
(8) Coal and aggregate severance tax (IC 6-10).

This provision will allow counties to use the funds from the new taxes.

A county treasurer must allocate the amount received among the county and each city and town within the county based on population. This allocation must be made as part of the June and December settlement each year.

Effect on Local Units As Employers. Costs to local units for products taxed could increase if the cost increases to the provider are passed through to the local unit.

Parks and Recreation Grant Fund. Expenditures from the fund may be used for the following purposes:

(1) To strengthen Indiana's economy by focusing investment on parks and recreation projects.

(2) To accelerate job creation through training and education initiatives to enhance the skills and employment prospects of Indiana's workforce in the parks and recreation industry.

(3) To facilitate the development of parks and recreation sites throughout Indiana.

(4) To encourage public-private partnerships focused on development of parks and recreation projects.

A person may apply for a grant from the fund using the procedures established by the board. A grant may not exceed 50% of the applicant's project costs.

The DOR may bring the action in the Marion County Circuit Court or in the circuit court of the county in which the taxpayers' business is located. This provision may increase costs to the counties.

Penalty Provision: A Class B misdemeanor is punishable by up to 180 days in jail. The average daily cost to incarcerate a prisoner in a county jail is approximately $44.

Explanation of Local Revenues:. *Highway, Road, or Street Purposes*. A county treasurer must allocate amounts among the county and each city and town within the county based on population. Money allocated to a county, city, or town must be deposited in the unit's fund that is dedicated to highway, road, or street purposes. Counties would receive $32.8 M.

Parks and Recreation Grant Fund. Local units would be eligible to receive about $8.2 M in grant money.

Penalties. If additional court actions occur and a guilty verdict is entered, local governments would receive revenue from the following sources: (1) The county general fund would receive 27% of the $120 court fee that is assessed in a court of record. Cities and towns maintaining a law enforcement agency that prosecutes at least 50% of its ordinance violations in a court of record may receive 3% of court fees. If the case is filed in a city or town court, 20% of the court fee would be deposited in the county general fund and 25% would be deposited in the city or town general fund. (2) A $3 fee would be assessed and, if collected, would be deposited into the county law enforcement continuing education fund. (3) A $2 jury fee is assessed and, if collected, would be deposited into the county user fee fund to supplement the compensation of jury members.

State Agencies Affected: DOR; DNR; Auditor of State; Treasurer of State.

Local Agencies Affected: Counties, county circuit courts, trial courts, local law enforcement agencies.

Information Sources: DOR; DNR; U.S. Geological Survey; Indiana Geological Survey.

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